FAQ: Building the Right Business Structure for Your Farm

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DISCLAIMER: This guide does not provide legal advice or establish an attorney-client relationship between the reader and author. Always consult an attorney regarding your specific situation.

The first question a farmer might ask about business structures may very well be: Why do I feel so overwhelmed? The good news is that creating a legally safe and well-managed business only involves three crucial steps: creating and following the processes laid out in your documents, separating yourself financially from the business, and getting legal advice when you need it. Here are some basic questions farmers often ask while moving through the process of establishing a business structure.

I'm not sure I want to form a business entity. Can't I just sell my products or services?

Yes, you can. And if you do, you'll be considered either a sole proprietor (if you're the sole owner of your business) or a partnership (if others co-own with you). You'll still have to obtain the licenses and registrations necessary in your state (and follow employment laws and other regulations), but if you do nothing else, you'll be designated a sole proprietorship or partnership by default.

Before you decide whether to stay a sole proprietor/partnership, make sure you understand the benefits of having a more formal business entity. The most significant benefit of forming a limited liability company (LLC) or corporation is that your personal assets will be protected from business liabilities—debt or judgments incurred by the business. As an LLC or corporation, your risk is limited to the amount that you have invested in the company, as long as you follow the rules. A more formal business entity can also help you raise funds from outside investors and can be beneficial to you at tax time.

FOR MORE INFORMATION: *Farm Commons'* Farmer's Guide to Choosing a Business Entity *contains over 300 pages of instructions and checklists about all the different business entities. Read pages 29–39 of the* Farmer's Guide *to learn more about sole proprietorships and partnerships.*

I want to move beyond just having a sole proprietorship or partnership. I've heard that I should form an LLC or S corporation. Which is better?

Both LLCs and S corporations allow you to protect your personal assets from your business' financial liabilities. Both follow "pass through" income taxation rules. The big difference is that S corporations allow owners who make more than the average in income to classify the excess as dividends, which enjoy a lower tax rate. However, LLCs can also enjoy that benefit by filing as an S corporation for taxation purposes.

Some people believe that LLCs are easier because the statutes often do not require an LLC to draft paperwork such as organizing documents or meeting minutes. However, the failure to write organizing documents or maintain meeting minutes can jeopardize the protection from liability. Many farmers choose between the LLC and corporation on factors such as personal experience or preference.

FOR MORE INFORMATION: *Many of Farm Commons' business entities resources are specifically devoted to helping you choose between having an LLC or a different kind of corporate structure. Complete the flowchart in chapter 2 (pages 21–24) of the* Farmer's Guide to Choosing a Business Entity *and read pages 40–61 and 171–175, among others. Farm Commons also has shorter guides to read, including* Farmer's Guide to LLCs, Farmer's Guide to S Corps, *and* Farmer's Guide to C Corps.

Is it worth it to file taxes as an S corporation?

You can elect to have the IRS treat your LLC as an S corporation for tax purposes. Farmers who make more income than the average farmer may find an advantage in doing so. This is because the amount of income made over the average may be classified as dividends rather than income, and dividends are taxed at a lower rate.

To be treated as an S corporation for tax purposes, the LLC must meet the eligibility requirements. There must be fewer than 100 members/shareholders, only one “class” of stock available to each member/shareholder, and only persons, trusts, or estates are members/shareholders (other corporations or LLCs may not be members/shareholders). There are special forms to fill out and deadlines to meet to make this designation. Talking to an accountant or attorney will be helpful in keeping track of the steps necessary to file as an S corporation.

FOR MORE INFORMATION: *Read chapter 4 (pages 232–245) of Farm Commons’* Farmer's Guide to Choosing a Business Entity. *An attorney specializing in tax law can also answer questions about the benefits and responsibilities of filing under S corporation status.*

Can I structure my farm as a nonprofit?

Yes, although many farms will have trouble meeting the requirements to receive 501(c)(3) tax classification, which is necessary to receive tax deductible donations and be competitive for grant funding. Most nonprofits are formed in two steps: (1) form a nonprofit corporation through the state, and (2) receive tax classification as a 501(c)(3) from the IRS. A nonprofit corporation can’t be owned by any one individual, sold for a profit, sell shares of stock, or have its assets used to benefit any one person or group. To receive 501(c)(3) classification, the organization must have—as its exclusive purpose—an eligible charitable, religious, or educational purpose. Farming is not easy to classify as an eligible purpose. Further, 501(c)(3) organizations are not supposed to compete in the marketplace with for-profit businesses. Because of these restrictions, sustainable farmers don’t often use a nonprofit model, although there are some nonprofit entities with components of farming in their purposes and operations.

FOR MORE INFORMATION: *Farm Commons’* Choosing a Business Entity: Flowchart *has many questions to help farmers decide whether a nonprofit model is the right way to go. For detailed steps and requirements to create a nonprofit, read chapter 6 (pages 261–270) of Farm Commons’* Farmer's Guide to Choosing a Business Entity.

How can forming a business entity help me pass my farm to a successor?

A well-planned business entity can ease succession planning for your farm. Having a formal business entity provides the opportunity to plan a clear process with a clear set of ground rules for how the transition will take place. Also, a formal business structure allows you to transfer the business as a whole, not just individual assets.

If you're thinking about using a business entity—or creating a new one—to ease the transfer of the farm to your children, you'll want to ask important questions now. Some of these questions will be about your vision, the big picture: Is your ultimate goal to establish an inheritance for your kids? What values do you want to make sure your farm reflects? Other questions will be financial and logistical: What are your assets? What debts does (or will) your business carry? What paperwork and record-keeping is required for the business you want to create or maintain? Attorneys and accountants can offer good advice on maintaining compliance with the law and providing for the payment of the estate's taxes, debts, and expenses.

FOR MORE INFORMATION: *Farm Commons'* Succession Planning *tipsheet contains lists and graphs to help with questions ranging from overall farm vision to retirement budgets and the long-term protection of business partners' interests. And if you decide to form a new business, other resources listed in this FAQ will all be useful.*

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About Farm Commons

Farm Commons is a nonprofit organization dedicated to empowering sustainable farmers with the legal resources they need. We create practical, user-friendly educational resources. We also support sustainable farmers in proactively implementing legal best practices, collaborating on innovative legal solutions, and encouraging each other as leaders creating the change they seek.

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